

Message Text

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ACTION NEA-10

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
INR-10 NSAE-00 ICA-11 TRSE-00 XMB-02 OPIC-03
SP-02 LAB-04 SIL-01 OMB-01 AGR-01 ABF-01 /063 W
-----012029 100205Z /73
R 090930Z AUG 78
FM AMEMBASSY COLOMBO
TO SECSTATE WASHDC 1076

C O N F I D E N T I A L COLOMBO 3619

E.O. 11652: GDS
TAGS: AFIN,EFIN, CE
SUBJECT: PLACEMENT OF EXCESS FUNDS IN TIME DEPOSITS

REF: (A) STATE 19386, (B) STATE 009602, (C) 77 COLOMBO 5039

1. SRI LANKA CONTINUES TO HAVE A SERIOUS LIQUIDITY PROBLEM. AFTER INCREASING 28.8 PERCENT IN 1977, THE MONEY SUPPLY (M1) ROSE A FURTHER 12.3 PERCENT IN THE FIRST FOUR MONTHS OF 1978 (LATEST PUBLISHED DATA). ALTHOUGH THE GOVERNMENT OF SRI LANKA (GSL) IS MAINTAINING TIGHT FISCAL AND CREDIT CONTROLS, COMMERCIAL BANK CREDIT TO THE PRIVATE SECTOR (TO FINANCE THE RECORD PADDY CROP AND THE HIGHER VALUE OF THE FOREIGN TRADE) AND RISING FOREIGN EXCHANGE RESERVES HAVE PUSHED UP THE MONEY SUPPLY. THE ANNUAL RATE OF INFLATION IS ESTIMATED AT 10-15 PERCENT.

2. DR.S. RAJALINGAM, DIRECTOR OF MONETARY POLICY, MINISTRY OF FINANCE, TOLD THE ECON OFFICER THAT PRELIMINARY DATA FOR MAY AND JUNE SHOW SMALL DECLINES IN THE MONEY SUPPLY, BUT THE JUNE FIGURE STILL REPRESENTS A YEAR-TO-YEAR GROWTH RATE OF ABOUT 20 PERCENT. RAJALINGAM SAID THE LEVEL OF IMPORTS IS EXPECTED TO INCREASE SHARPLY IN THE SECOND HALF OF 1978 WHICH SHOULD ACT TO REDUCE FOREIGN EXCHANGE RESERVES AND TO SLOW MONEY SUPPLY GROWTH. FOR THE MOMENT, HOWEVER, EXCESS LIQUIDITY IS STILL EXERTING
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CONSIDERABLE INFLATIONARY PRESSURE ON THE ECONOMY. UNTIL THERE IS A SIGNIFICANT REDUCTION IN DOMESTIC LIQUIDITY, RAJALINGAM WOULD PREFER THAT THE USG CONTINUE TO HOLD THE BULK OF ITS DEPOSITS IN THE GSL TREASURY ACCOUNT.

3. REGARDING REFTTEL A SUGGESTION THAT THE GSL TREASURY

PAY A HIGHER RATE OF INTEREST THAN THE PRESENT 7.5 PERCENT, RAJALINGAM SAID THE TREASURY IS PROHIBITED FROM PAYING ANY HIGHER RATE OF INTEREST. THE USG RECEIVES THE SAME RATE OF INTEREST AS STATE CORPORATIONS WHICH ARE REQUIRED TO HOLD TREASURY ACCOUNTS.

4. THE PRESENT ARRANGEMENT,WHICH ALLOWS THE EMBASSY (AND FADPC BANGKOK SINCE JUNE 1) TO TRANSFER FUNDS FROM TREASURY TO THE DEMAND ACCOUNT WITH GRINDLAYS, WORKS WELL. THE USG IS DRAWING 7.5 PERCENT INTEREST ON WHAT IS IN EFFECT A DEMAND ACCOUNT WITH THE TREASURY. THE BALANCE IN THE TREASURY ACCOUNT HAS REGISTERED LARGE SWINGS AND, AT ONE POINT EARLIER THIS YEAR,IT APPEARED AS THOUGH FUNDS WOULD HAVE TO BE DRAWN FROM THE GRINDLAYS TIME DEPOSIT TO MEET PAYMENT OBLIGATIONS. GIVEN THE OFTEN GREAT DIFFERENCE IN TIMING BETWEEN DEPOSITS AND WITHDRAWALS, THE EMBASSY WONDERS ABOUT THE PRACTICALITY OF TYING UP A SIGNIFICANT PORTION OF USG EXCESS FUNDS IN A ONE-YEAR COMMERCIAL BANK TIME DEPOSIT.

5. EMBASSY RECOMMENDATION: GIVEN SRI LANKA'S CONTINUED LIQUIDITY PROBLEM, THE EMBASSY RECOMMENDS THAT PRESENT ARRANGEMENT WITH THE TREASURY BE CONTINUED FOR ANOTHER SIX MONTHS,AT WHICH TIME THE SITUATION WOULD AGAIN BE REVIEWED.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: BANK SERVICES, LIQUIDITY (MONETARY)
Control Number: n/a
Copy: SINGLE
Draft Date: 09 aug 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978COLOMB03619
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D780326-1125
Format: TEL
From: COLOMBO
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780884/aaaacsfsz.tel
Line Count: 94
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: d5f16d66-c288-dd11-92da-001cc4696bcc
Office: ACTION NEA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 2
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 78 STATE 19386, 78 STATE 9602, 77 COLOMBO 5039
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 06 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 1796626
Secure: OPEN
Status: NATIVE
Subject: PLACEMENT OF EXCESS FUNDS IN TIME DEPOSITS
TAGS: AFIN, EFIN, CE
To: STATE
Type: TE
vdkgvwkey: odbs://SAS/SAS.dbo.SAS_Docs/d5f16d66-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014